

§ 1.306-1

26 CFR Ch. I (4-1-03 Edition)

section 305(b)(4) is not applicable to the distribution.

[T.D. 7281, 38 FR 18539, July 12, 1973]

§ 1.306-1 General.

(a) Section 306 provides, in general, that the proceeds from the sale or redemption of certain stock (referred to as “section 306 stock”) shall be treated either as ordinary income or as a distribution of property to which section 301 applies. Section 306 stock is defined in section 306(c) and is usually preferred stock received either as a non-taxable dividend or in a transaction in which no gain or loss is recognized. Section 306(b) lists certain circumstances in which the special rules of section 306(a) shall not apply.

(b)(1) If a shareholder sells or otherwise disposes of section 306 stock (other than by redemption or within the exceptions listed in section 306(b)), the entire proceeds received from such disposition shall be treated as ordinary income to the extent that the fair market value of the stock sold, on the date distributed to the shareholder, would have been a dividend to such shareholder had the distributing corporation distributed cash in lieu of stock. Any excess of the amount received over the sum of the amount treated as ordinary income plus the adjusted basis of the stock disposed of, shall be treated as gain from the sale of a capital asset or noncapital asset as the case may be. No loss shall be recognized. No reduction of earnings and profits results from any disposition of stock other than a redemption. The term *disposition* under section 306(a)(1) includes, among other things, pledges of stock under certain circumstances, particularly where the pledgee can look only to the stock itself as its security.

(2) Section 306(a)(1) may be illustrated by the following examples:

Example (1). On December 15, 1954, A and B owned equally all of the stock of Corporation X which files its income tax return on a calendar year basis. On that date Corporation X distributed pro rata 100 shares of preferred stock as a dividend on its outstanding common stock. On December 15, 1954, the preferred stock had a fair market value of \$10,000. On December 31, 1954, the earnings and profits of Corporation X were \$20,000. The 50 shares of preferred stock so distrib-

uted to A had an allocated basis to him of \$10 per share or a total of \$500 for the 50 shares. Such shares had a fair market value of \$5,000 when issued. A sold the 50 shares of preferred stock on July 1, 1955, for \$6,000. Of this amount \$5,000 will be treated as ordinary income; \$500 (\$6,000 minus \$5,500) will be treated as gain from the sale of a capital or non-capital asset as the case may be.

Example (2). The facts are the same as in *Example 1* except that A sold his 50 shares of preferred stock for \$5,100. Of this amount \$5,000 will be treated as ordinary income. No loss will be allowed. There will be added back to the basis of the common stock of Corporation X with respect to which the preferred stock was distributed, \$400, the allocated basis of \$500 reduced by the \$100 received.

Example (3). The facts are the same as in *Example 1* except that A sold 25 of his shares of preferred stock for \$2,600. Of this amount \$2,500 will be treated as ordinary income. No loss will be allowed. There will be added back to the basis of the common stock of Corporation X with respect to which the preferred stock was distributed, \$150, the allocated basis of \$250 reduced by the \$100 received.

(c) The entire amount received by a shareholder from the redemption of section 306 stock shall be treated as a distribution of property under section 301. See also section 303 (relating to distribution in redemption of stock to pay death taxes).

[T.D. 6500, 25 FR 11607, Nov. 26, 1960, as amended by T.D. 7556, 43 FR 34128, Aug. 3, 1978]

§ 1.306-2 Exception.

(a) If a shareholder terminates his entire stock interest in a corporation—

(1) By a sale or other disposition within the requirements of section 306(b)(1)(A), or

(2) By redemption under section 302(b)(3) (through the application of section 306(b)(1)(B)),

the amount received from such disposition shall be treated as an amount received in part or full payment for the stock sold or redeemed. In the case of a sale, only the stock interest need be terminated. In determining whether an entire stock interest has been terminated under section 306(b)(1)(A), all of the provisions of section 318(a) (relating to constructive ownership of stock) shall be applicable. In determining whether a shareholder has terminated